

Fiscal and Structural Subgroup—Meeting Four Minutes

October 26, 2020

9:00 AM

Virtual Meeting

<https://www.youtube.com/watch?v=DzDUbpAT0f0>

Meeting Attendees:

Dep. Sec. of Public Safety and Homeland Security Jae Davenport, on behalf of Sec. Brian Moran
Asst. Sec of Health and Human Resources Catie Finley, on behalf of Secretary Daniel Carey
Jenn Michelle Pedini (Virginia NORML)
Commissioner Jewel Bronaugh (VDACS)
Ngiste Abebe (Columbia Care)
Dr. David Brown (Department of Health Professions, on behalf of Caroline Juran)
Kristen Collins (Tax Department), on behalf of Commissioner Craig Burns
Mike MacKenzie (VCU Wilder School)
Colby Ferguson (DMV)
Cam Gutshall (DMV)
Travis Hill (ABC)
Charles Green (VDACS)
David Barron (DFS)

Staff:

Deputy Secretary of Agriculture Brad Copenhaver
Jacquelyn Katuin, Policy Advisor to Secretary Moran

Commissioner Bronaugh began the meeting at 1:05 PM.

Minutes from the October 15th meeting were not yet ready for review or approval.

Group Discussion

Commissioner Bronaugh reviewed a document (attached at the end of these minutes) with the group regarding topics and potential consensus recommendations.

Regulatory Structure

Dr. Bronaugh: We will start with regulatory structure—from our discussion we have captured that “Virginia should consider either putting its cannabis regulatory structure under one agency or an umbrella agency to cover both adult use and medical marijuana. There has also been discussion about including regulation of industrial hemp and/or hemp-derived products intended for human consumption under this agency”

Mr. Green: We did some research looking around the country, and as far as the cultivation of the crop goes, that is handled by either USDA or the state in every state. As far as the products

intended for human consumption, that seemed to be handled by a food inspection entity. That is not an endorsement of how we need to do it, but is just a lay of the land.

Dr. Bronaugh: In terms of the production and grower side, we have built a lot of trust with the growers and VDACS over the last 5 years. There would likely be some angst among these producers if they are moved to another agency. That does not mean that it would not work, but that is just a consideration.

Mx. Pedini: While a lot of work has been done to develop Virginia's program and bring us into USDA compliance, there is still a lot of concern on the product side—smokable hemp and products included for human consumption. There is no authority for consumer safety over the smokable hemp right now; there could be adulterants. Providing consumer safety is critical. We need to think about how we do this.

Mr. Green: We have a lot of concern as well about those potential adulterants.

Mx. Pedini: There is also a lack of overlap of the regulation of the advertising of these hemp-derived products.

Ms. Abebe: We have a number of regulatory processes in process now, and we need to make sure that anything that is in a waiting period or public comment period now stays on track and on the right timelines.

Dep. Sec. Copenhaver: Something else we need to remember is building in flexibility for whatever regulatory body this ends up in to move as quickly as the industry does.

Industry Structure

Dr. Bronaugh: The notes talk about allowing but not requiring vertical integration. The legal and regulatory subgroup agreed.

Dep. Sec. Copenhaver: We have discussed this a lot. A good point that came up before is that we already have businesses operating here in our medical program that are vertically integrated.

Licensing Structure

Dr. Bronaugh: We have looked at the structure and the steps of the industry supply chain, from grower to social consumption. We have talked about social equity licenses. We have not discussed setting the number of licenses, but is this something we want to weigh in on? And license fees should not be an insurmountable barrier to entry.

Dep. Sec. Copenhaver: Do we need to include a dealer (such as in the industrial hemp law) license (someone who actually takes possession of the product and moves it through commerce)?

Mx. Pedini: Wholesaler would be an appropriate catch-all.

Mr. Hill: You will need to spend some time spelling out which activities they can be engaged in. Does holding one of these prohibit doing activities covered in the other? It can get very confusing if you are requiring many different licenses. Or should Virginia create a license that allows many different activities?

Ms. Abebe: The Illinois model allows those who hold a cultivator license to do infusing as well, but you can also get an infuser license too. Also, what is the difference between a license and a permit? For example, if someone is already a licensed caterer, could they get a separate permit to do cannabis hospitality?

Mr. Hill: If you are going to start using those two terms differently, we need to define what a license is and what a permit is.

Ms. Abebe: One difference is that a license is something that is regulated by the state that has a calendar cycle for applications and issuance, and a permit could have a rolling application period and related to something else that they already have a license for. And not all of these need to be made available at the exact same start date in order to have a deliberate expansion.

Dr. Bronaugh: Does ABC have any experience that could inform how we set this up in terms of allowing specific or multiple activities as a part of a license?

Mr. Hill: We actually just led a license consolidation license effort, because over 80 years, we went from 5 licenses to 170 different licenses or combinations. This became very confusing, and we cut our license type numbers in half. We should try to create as few licenses as possible that allow as broad of activity as possible—this would make it much easier for the businesses.

Mx. Pedini: We would probably need to include a vertical option.

Mr. Hill: That would be an approach because then you could see who in the industry is doing that. We also need to think about how we would price all these licenses.

Mx. Pedini: It is a higher cost for the vertical license in the medical program than for when the companies will license their additional retail locations.

Dep. Sec. Copenhaver: This is an area in the report where we can have a robust discussion about what the thought process and considerations should be. We can learn from other agencies, like ABC and the VA Lottery.

Mx. Pedini: We should also include how we would license existing licensees (i.e. the existing medical licensees)—thinking about the time gap between when we legalize the product and when we have a new licensing system set up.

Ms. Abebe: In Illinois, they used license fees from the existing business to fund some of the startup costs. There is an ongoing conversation going on right now about how to cap or not cap licenses. It would be good to have a deliberate process for how to expand the number of licenses. Illinois is having some litigation associated with the first round of licenses, which is common in

most states as people are learning the process. It is helpful to start out with a bold but modest series of licenses and then do an annual analysis of how things are going. It is easy to release more licenses, but it is much harder to take licenses away. It is easier to connect with capital if you are one of a smaller number of licensees as well.

Mr. Hill: With the start of a market, it probably makes sense to limit the number of licenses at first. Virginia does not limit the number of licenses for alcohol, and we have zoning laws that dictate where businesses can locate. The market also dictates who is successful. If you limit the number of licenses, what you could do long term is create a license that is highly valuable, which can concentrate market power, reduce services to consumers, and create regulatory challenges. We need to frame up how we get off on the right foot but then also allow the market forces and individual communities play a role.

Ms. Abebe: One other point to consider is geography. In Virginia, we have one pharmaceutical processor per health service area. In Illinois, when they did an expansion of licenses, the applicant had to specify where geographically they wanted to locate. The areas were divided up and licenses were proportionally awarded based on population. This was a way to focus the competition pool. This may be a good model for Virginia as well.

Dr. Bronaugh: Also from geography, you can sometimes determine who is lacking in resources as well.

Dr. Brown: We could cap license numbers for certain categories but not for others. For example, we could limit processors and distributors, but not retail, delivery, etc.

Mx. Pedini: Question for Ms. Abebe—in other states are licenses broken down by the size and scale of the operation?

Ms. Abebe: In Illinois, they only released social equity microgrow licenses, but there is a process for expansion. The other thing to consider is if licensees can expand or operate in additional areas.

Mr. Green: In our research, we have found other states have different levels of licenses for growers based on the size of the grow operation. We heard that we need to be careful in how we set that up because in one state, applicants tried to get around the cap on the large size of grows by applying for many licenses in the small size.

Mx. Pedini: We should probably mention that it would be good to offer a “microgrow” licenses and use canopy size as opposed to plant count.

Ms. Abebe: That’s a good point because we could run into issues when using plant count. We should also think about how to create a license for consumers to come see the operation and consume on site as well—like a brewery or winery.

Dr. Bronaugh: We need discuss some about license fees and what that should look like specifically for a social equity license category.

Mr. Hill: First we need to figure out what license fees go to support. Do they need to be set up so they only support the regulatory program? We could also look at setting up fees across the board and know that taxation will go toward funding these activities. If the social equity license fees are much lower, some within the industry may complain about that.

Ms. Abebe: Thus far, we haven't seen industry members pushing back on the fee differences for social equity licenses. In Illinois, it was \$100,000 for an existing medical licensee to get a license to sell for adult use. The license fees for social equity applicants were \$2,500.

Taxation

Dr. Bronaugh: What we have so far—"Virginia should consider taxation of product at the retail level—this is the most straightforward and easy to collect. Question: Which agency do we want to manage this process—a cannabis agency, tax department, or something else?"

Dep. Sec. Copenhaver: Another wrinkle in this could be that for the time being, this is primarily a cash-based business, which could create additional problems for the state agency who is collecting the taxes.

Ms. Abebe: There are some stories from early states where people were trying to pay large sums in taxes in cash. Moving to the second bullet, Illinois has a higher tax on higher potency products, and this is also similar to Virginia's alcohol model—i.e. higher tax on spirits.

Mr. Hill: Yes there are different tax rates for spirits, malt beverages, and wine.

Ms. Abebe: In the health work group, we talked about using taxes to meet public health goals in this way. But high potency does not necessarily mean higher intoxication—it usually just means more doses. Most states have just focused on retail, collecting a sales tax and a cannabis specific excise tax on top of that. It would be important that whatever system we decide on is simple to implement and works with point of sale systems.

Ms. Collins: We would definitely have concerns with receiving large amounts of cash. When we look at an industry specific tax, we would need to consider both subject matter expertise and the law enforcement capability. Most tax department programs are voluntary compliance. So we would have some concerns about having to collect the tax for those reasons.

Ms. Abebe: For the most part, cannabis operators are able to write checks now and have access to some banking solutions.

Dr. Bronaugh: The last bullet states that "A tax rate should be high enough to cover costs of the program to provide consumers with certainty that products are regulated and safe (e.g. free from adulterants) to consume and to cover any other revenue goals Virginia has—however, the tax rate should not be high enough that it encourages a thriving illicit black market." We need to think about what we would want to cover with these taxes.

Mr. Hill: In the experience of ABC, generally the easiest thing to do is to collect the most amount of money from the fewest amount of people—so much of ABC’s tax collection happens at the wholesale level. But where you place the tax in the chain does have impacts on its visibility and the ability to pass that tax on.

Mr. MacKenzie: To what degree would local jurisdictions be able to implement their own tax structure?

Dep. Sec. Copenhagen: That’s a great question and will likely come into play in our discussion of local input in general.

Mr. Hill: Yes, that is a great point. And often localities need direct authorization to collect a tax. But we have seen sometimes in the past with alcohol, when times get tight, the legislature sweeps money out of those accounts.

Ms. Abebe: We would already be beholden to any sales tax that exists in the locality. In other states, generally if a state opts out of cannabis, they are no longer eligible to receive any funds generated by the industry.

Dep. Sec. Copenhagen: Jason Powell in the chat box asked, “Would local taxes not depend on the ultimate retailer? If private, would they not get BPOL?” That is probably correct, but there is probably also an additional policy discussion that localities would want to have about this particular product.

Dr. Bronaugh: We need to continue to have discussion about how localities play into this.

Dep. Sec. Copenhagen: JLARC is also getting into this, so we will probably just say that localities need to be at the table for this discussion.

Agency Organization

Dep. Sec. Copenhagen: This will probably be a pretty robust agency structure that covers different facets of regulating this product. This would include licensing and registration staff, auditing and Investigation Staff (law enforcement background), financial Analysts/Financial Processing, Data Analysts, Software provider: Seed to Sale Tracking System, Scientific or laboratory, Internal Support positions – (i.e. Human Resources, FOIA), Areas to address outside of the primary regulator: Tax Revenue Collections, Other Law Enforcement, Liaison Positions such as pesticides, food safety, weights and measures, Dept. of Agriculture. We need to think a lot about the organization structure and try to get it right from the beginning.

Dr. Bronaugh: A lot of that list comes from discussions we have had with several other states.

Dr. Brown: We have done a good job of listing the spectrum of activity necessary. This is likely way beyond what BOP could do, but we would likely have a role in this (such as issuing permits for facilities producing medical grade products).

Dr. Bronaugh: Charles Green wanted to note that existing agencies have some authority in some of those support roles.

Ms. Abebe: We should also consider a structure to allow for citizen input aside from the standard stuff.

Dr. Bronaugh: We can never forget allowing for that input when we are making decisions.

Dep. Sec. Copenhagen: Another bullet says “Virginia should create regulatory authority for the agency to establish a program and appropriate funding, as opposed to developing the program based on tax revenue and fees. Recognition that up-front funding and established FTEs will be critical to start a program before license fees and tax revenues materialize. Consideration of a Cannabis Cabinet of agencies or Secretariats mandated to come together on a regular basis for updates and address challenges of program start-up to alleviate the potential “red tape” that could be experienced bringing multiple state agencies together working with different regulatory authority. The report should work with staff to develop cost estimates for establishing new agency structure, including relevant timelines.”

Dr. Bronaugh: This is extremely important. Giving the agency the necessary authority and the appropriate funding is key because when we start a new program, the public expects it to roll out smoothly and in a timely manner.

Dep. Sec. Copenhagen: Are there any other topics we need to make sure we include?

Mx. Pedini: It would probably be appropriate that we recommend transparency in the licensing process.

Mr. Hill: Does that include posting and publishing, or how licenses are crafted?

Mx. Pedini: Ultimately it depends on what the process looks like, but when we have awarded highly competitive licenses in an opaque manner in the past, that has created legal problems for the state. We should have transparency on how the license winners are ultimately decided on.

Mr. Hill: Like published criteria and scoring matrices?

Mx. Pedini: Yes, and what the scores were as well. We should also collect data and have regular reporting on monthly sales, number of employees, and other items.

Dep. Sec. Copenhagen: That fits into the broader theme of data collection we have discussed.

Mx. Pedini: There should also be an easy to navigate website as well.

Dep. Sec. Copenhagen: We are open to other thoughts at any time after this meeting and during our Wednesday meeting as well.

Public Comment

There was no public comment in this meeting.

Commissioner Bronaugh adjourned the meeting at 10:25 AM.